

10/03/05

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
GAINESVILLE DIVISION

IN RE: : CHAPTER 11
: JOINTLY ADMINISTERED
CLC OF DAHLONEGA LLC, et al., :
: CASE NOS. 04-21769 through
Debtors. : 04-21773 and 04-21796
: through 04-21817 and 04-22478
: JUDGE BRIZENDINE

**ORDER DEFERRING DEBTORS' OBJECTION
TO CLAIMS FOR PUNITIVE DAMAGES**

Before the Court is the objection of the above-named Debtors filed on March 21, 2005 regarding certain proofs of claim for punitive damages filed by various claimants alleging personal injuries and wrongful deaths.¹ During a hearing held on May 2, 2005, the Court directed counsel to submit briefs on the issue of whether said claims should be determined as of the petition filing date in this case. The Court having reviewed the legal argument of counsel, as well as the applicable case law and record, finds and concludes as follows.

As argued by Debtors, the Eleventh Circuit has previously held that allowing claims for punitive damages in a bankruptcy case is inappropriate as same forces innocent creditors to compensate for debtors' wrongdoing as the allowance of such claims dilutes or precludes recovery on their own claims. *See Novak v. Callahan (In re GAC Corp.)*, 681 F.2d 1295, 1301 (11th Cir. 1982). This reasoning appears sound though it has been subjected to criticism in the

¹ Debtors also filed a motion for order approving claims estimation and liquidation procedures concerning a proposed method for estimating and liquidating said claims. This issue has been addressed by separate orders. The objection herein seeks to narrow the issues to be resolved in connection with the approved procedure.

recent decision of *In re A.G. Financial Serv. Center, Inc.*, 395 F.3d 410, 414 (7th Cir. 2005), wherein the Seventh Circuit admonishes a stricter standard of adherence to state law treatment of punitive claims and its extension to insolvent defendants.² Confronting a similar issue, the court in the case of *In re Hillsborough Holdings Corp.*, 247 B.R. 510 (Bankr. M.D.Fla. 2000) considered the allowance of punitive damages claims and concluded that same should be disallowed if “the allowance of such claims would render a determination of the feasibility of the Plan impossible ... or place in jeopardy a confirmed Plan of Reorganization.”³

The Court acknowledges the criticism offered in *A. G. Financial* and that same should be included as part of this Court’s deliberation herein. Punitive damages claims should not automatically be prohibited in a bankruptcy case, nor should they automatically be allowed. Instead, the question of their allowance must be analyzed consonant with both state law interests in punishing liable parties coupled with concerns for equitable claims distribution in a bankruptcy case, all of which calls for an independent assessment by the bankruptcy court. *Compare In re Allegheny International, Inc.*, 106 B.R. 75 (Bankr. W.D.Pa. 1987). Moreover, as observed in *A.G. Financial*, when state law permits punitive damages against an insolvent defendant as argued by claimants herein under applicable Mississippi law, the question of subordination of

² The Court further notes, however, that during this same term in another bankruptcy related decision on a different issue, the Seventh Circuit adopted a rationale similar to that of the Eleventh Circuit under which the circuit court allowed a correction on grounds that a refusal to do same would merely impose a ‘capricious redistribution’ of payments upon creditors while serving “no deterrent or punitive purpose.” *In re UAL Corp.*, 411 F.3d 818, 824 (7th Cir. 2005).

³ 247 B.R. at 512, citing *In re A.H. Robins Co.*, 89 B.R. 555 (E.D.Va. 1988); *In re Johns-Manville Corp.*, 68 B.R. 618 (Bankr. S.D.N.Y. 1986), *aff’d in part, rev’d in part*, 78 B.R. 407 (S.D.N.Y. 1987), *aff’d sub nom.*, *Kane v. Johns-Manville Corp.*, 843 F.2d 636 (2^d Cir. 1988).

such claims under 11 U.S.C. § 510(c)(1) could become an important consideration in weighing and properly attending to the competing interests that intervene when a defendant is a debtor in bankruptcy. 395 F.3d at 414, citing *United States v. Noland*, 517 U.S. 535, 116 S.Ct. 1524, 134 L.Ed.2d 748 (1996). An assessment of such issues is best undertaken only after a thorough examination of a submitted proposed plan of reorganization.

In sum, although punitive damages claims should not be automatically disallowed, the admonitions of *A.G. Financial* notwithstanding, this Court believes that the decision of the Eleventh Circuit in *GAC Corporation* better addresses a situation in which a proposed plan dilutes the claims of creditors while serving no deterrent or punitive interest in relation to the debtor, who is the party alleged to have caused the injurious conduct in question in the first place. As suggested above, however, this Court concludes that examination of a proposed plan of reorganization along with a disclosure statement as submitted for approval will best allow the Court to analyze the relevant concerns of all affected parties herein.

Accordingly, based upon the above reasoning, it is


ORDERED that the objection of the above-named Debtors filed on March 21, 2005 regarding certain proofs of claim for punitive damages filed by various claimants alleging personal injuries and wrongful deaths be, and hereby is, **deferred** pending review of any proposed plan of reorganization and disclosure statement consistent with the foregoing discussion. The parties will be notified by the Court should additional briefs or argument be necessary for the Court's decision.

The Clerk is directed to serve a copy of this Order upon counsel for the Debtors,

counsel for the punitive damages claimants, and the U.S. Trustee.

IT IS SO ORDERED.

At Atlanta, Georgia this 3rd day of October, 2005.



ROBERT E. BRIZENDINE
UNITED STATES BANKRUPTCY JUDGE